

January 18, 2005

Commissioner Deborah Platt Majoras
Commissioner Orson Swindle
Commissioner Thomas B. Leary
Commissioner Pamela Jones Harbour
Commissioner Jon Leibowitz

Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, DC 20580

Dear Commissioners:

The Electronic Frontier Foundation (EFF) submits the following written comments in response to the Federal Trade Commission's (FTC) invitation for public comments in connection with its December 2004 workshop on peer-to-peer (P2P) file-sharing technology.

These written comments supplement the oral testimony provided by EFF during the December 16, 2004 session of the FTC workshop, on the panel moderated by John Delacourt, Chief Antitrust Counsel, FTC Office of Policy Planning, entitled "P2P File-Sharing and its Impact on Copyright Holders."

Is the Sky Falling?

To hear the entertainment industries, you would think that P2P file-sharing has brought them to the brink of financial ruin. The music industry, in particular, has been quick to blame P2P file-sharing technologies for the downturn in CD sales in recent years. The motion picture industry has suggested darkly that P2P file-sharing represents an imminent threat to their business prospects, as well.

There are reasons to treat these dark predictions with a grain of salt, however. Historically, entertainment industry incumbents have often "cried wolf" when confronted by new technologies that disrupt their existing business models. Nevertheless, for the last 100 years these new technologies have invariably ended up creating new business opportunities that enhance the welfare of copyright holders.¹

Several examples are telling. At the turn of the twentieth century, the invention of the player piano sparked much concern on the part of musical composers. In fact, renowned American composer John Philip Sousa published an editorial in 1906 attacking the player piano, declaring that it represented a threat to copyright owners and, indeed, the future of music in

¹ See Jessica Litman, DIGITAL COPYRIGHT (2001) at 106-07, 173 (discussing historical examples, including player piano, jukeboxes, cable television, VCRs).

America.² Of course, the player piano ultimately gave way to the phonograph, from which the entire modern music industry arose.

More recently, the motion picture industry attacked the video cassette recorder (VCR) as a threat to the future of film. In 1982, Jack Valenti, then-head of the Motion Picture Association of America (MPAA), famously declared, “I say to you that the VCR is to the American film producer and the American public as the Boston strangler is to the woman home alone.”³ The argument was that unauthorized home taping of movies and television shows would destroy the industry. After the Supreme Court upheld the legality of distributing VCRs in 1984, Hollywood discovered that the success of the VCR unleashed a new gusher of revenues from the home video market. In fact, since the late 1980s, home video revenues have exceeded box office revenues.⁴

These historical lessons suggest that claims by copyright holders that new technologies will devastate their industries should be taken with a grain of salt. After all, incumbent industry leaders never welcome innovations that disrupt familiar, entrenched business models, even when those innovations promise to grow the industry in the long term. This phenomenon has been referred to as the “Innovator’s Dilemma.”⁵

Of course, despite the unpopularity of innovators with established industry incumbents, it is ultimately innovation that is the engine of economic development and growth, as much for copyright holders as any other sector of our economy. Old business models are replaced by new; short-term disruption often creates opportunities for long-term growth.

The State of P2P File-Sharing Today

P2P file-sharing is a mainstream, widespread phenomenon in the United States today. Estimating the number of P2P users is difficult, especially as an increasing number of users choose to be “leechers” (i.e., only download files, rather than uploading as well) in order to avoid being targeted for lawsuits by the recording industry. Nevertheless, recent surveys put the number of Americans actively using P2P software at greater than 20 million, or roughly 1 of every 6 Americans who have internet access.⁶

The available evidence further suggests that P2P usage continues to grow, despite the highly publicized campaign of lawsuits mounted over the last year by the recording industry. Leading P2P monitoring services, like BayTSP and Big Champagne, report that P2P usage has continued unabated during 2004.⁷ A recent comprehensive study by researchers with the

² See John Philip Sousa, *The Menace of Mechanical Music*, Appleton’s Magazine (1906) (available at <<http://www27.brinkster.com/phonozoic/menace.htm>>).

³ See Home Recording of Copyrighted Works, Hearings before the Subcommittee on Courts, Civil Liberties, and the Administration of Justice of the Committee of the Judiciary, House of Representatives, 97th Cong., 2d Sess. (1982) (available at <<http://cryptome.org/hrcw-hear.htm>>).

⁴ See Harold L. Vogel, ENTERTAINMENT INDUSTRY ECONOMICS (5th ed. 2001) at 91.

⁵ See Clayton M. Christensen, THE INNOVATOR’S DILEMMA (1997).

⁶ See Lee Rainie, Mary Madden, et al., The State Of Music Downloading And File-Sharing Online, Pew Internet & American Life Project (April 2004) (available at <http://www.pewinternet.org/pdfs/PIP_Filesharing_April_04.pdf>).

⁷ See William Glanz, *Music Pirates Turn Up Volume*, WASH. TIMES (Sept. 6, 2004) (available at <<http://washingtontimes.com/business/20040905-102719-1426r.htm>>); John Borland, *Kazaa Loses P2P Crown*, CNET News.com (Oct. 11, 2004) (available at <http://news.com.com/Kazaa+loses+P2P+crown/2100-1038_3-

University of California and Cooperative Association for Internet Data Analysis found that, despite the music industry lawsuits, “if measured accurately, P2P traffic has never declined; indeed we have never seen the proportion of p2p traffic decrease over time (any change is an increase) in any of our data sources.”⁸

Impact on Copyright Holders?

Despite the growing popularity of P2P file-sharing, and the widespread use of these networks to share major label music (and, to a lesser extent, popular movies and television programs), there is a growing body of evidence that suggests that the use of P2P networks may not, in fact, be causing nearly as much harm to copyright holders as their public statements suggest.

In fact, viewing all the available evidence, the only conclusion that can fairly be drawn is that it is too soon to say whether and how much P2P file-sharing may or may not be harming the music and motion picture industries. For example:

- **CD Sales are Up.** Despite the growing popularity of P2P file-sharing during 2004, CD sales grew in the United States during 2004.⁹ This reversal in sales trends can be obscured by misleading numbers issued by the Recording Industry Association of America (RIAA), which has been criticized for mixing “units shipped,” international figures, and revenue figures in its public statements, none of which speak to the question of how many CDs are being sold.¹⁰ Moreover, the RIAA often fails to take into account the rapid growth of “singles” sales in the form of individual digital downloads purchased from authorized music services like the iTunes Music Store.
- **Other Factors Depress Sales.** A recent story in the *Economist* revealed, “According to an internal study done by one of the majors, between two-thirds and three-quarters of the drop in sales in America had nothing to do with internet piracy.”¹¹ To the extent that CD sales have dropped since the record-breaking years of the late-1990s, many factors are likely involved, including the recession, increasingly limited playlists on FM pop radio, the lack of a new format to replace the aging CD, the arrival of new competitors (e.g., video games, DVD, internet) for consumer dollars and time, a smaller number of releases, higher CD prices and the consolidation of music retailing in the hands of mega-retailers like Wal-mart.
- **The Canadian Experience.** In March 2004, the music industry suffered a major legal defeat in Canada, when a court announced that noncommercial P2P file-sharing (both downloading and uploading) is legal under Canadian copyright law. The ruling made

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⁸ See Thomas Karagiannis, et al., *Is P2P Dying or Just Hiding?* (2004) (available at <<http://www.caida.org/outreach/papers/2004/p2p-dying>>).

⁹ See *U.S. Sees Growth in CD Sales Market*, BBC News (Jan. 6, 2005) (Soundscan numbers show 2.3% increase in U.S. sales for 2004) (available at <<http://news.bbc.co.uk/2/hi/entertainment/4150747.stm>>).

¹⁰ See Moses Avalon, *Nielsen Rating System at Odds with RIAA's Claim of "Lost Sales"* (May 5, 2004) (available at <<http://www.kensei-news.com/cgi-bin/bizdev/exec/view.cgi/21/23374>>).

¹¹ *Music's Brighter Future*, THE ECONOMIST (Oct. 28, 2004) (available at <http://www.economist.com/business/displayStory.cfm?story_id=3329169>).

the front pages of a number of Canadian newspapers and enjoyed nation-wide media attention. Nevertheless, in the six months following the court's ruling, CD sales *rose* 12.4% in Canada over the prior year.¹² This suggests that the correlation between file-sharing and harm to the music industry is much more complex than the industry would suggest.

- **The Australian Experience.** Similarly, CD sales in Australia have soared during the same period that P2P file-sharing has flourished, increasing from 39 million units in 1998 to more than 50 million units in 2003.¹³
- **Oberholzer and Strumpf Study.** In March 2004, economists from Harvard University and the University of North Carolina published a research paper comparing downloading behavior with CD sales and concluded that “the impact of downloads on sales continues to be small and statistically indistinguishable from zero.”¹⁴
- **Music Industry Profits.** Many of the major music industry firms are owned by large multinational conglomerates, making it difficult to obtain information about their profitability. Nevertheless, the information that is available suggests that many of these companies remain profitable despite the recent upheavals in the industry. For example, as part of their recent bid to merge, Sony Music and BMG revealed that they were both profitable in recent quarters, with BMG enjoying the most successful quarters in its corporate history.¹⁵ EMI Music Publishing, one of the world's largest music publishing companies, also recently trumpeted that it has maintained profits of roughly £100 million over each of the last five years.¹⁶
- **Artists are not Afraid of P2P.** In the first comprehensive survey of musicians' attitudes concerning the impact of P2P file-sharing on the music industry, the Pew Internet & American Life Project found that “[a]mong the musicians in our online survey, two-thirds say file-sharing poses a minor threat or no threat at all.”¹⁷
- **New Business Models are Emerging.** Although major labels continue to turn their back on the public P2P file-sharing networks, an increasing number of artists are beginning to explore ways in which they might take advantage of them. One company demonstrating the potential of the “if you can't beat them, join them” approach is Weed, which has helped big-name artists like Heart to use “super-distribution” to

¹² Michael Geist, *Numbers Don't Crunch Against Downloading*, TORONTO STAR (Nov. 29, 2004).

¹³ See *Music Industry Way Off Track With Song And Dance About Falling Sales*, SYDNEY MORNING HERALD (MAR. 29, 2004) (available at <<http://www.smh.com.au/articles/2004/03/28/1080412234274.html>>); *Forget The Spin, Taping Is Not Killing Music*, SYDNEY MORNING HERALD (Dec. 31, 2003) (available at <<http://www.smh.com.au/articles/2003/12/30/1072546532286.html>>).

¹⁴ Felix Oberholzer & Koleman Strumpf, *The Effect of File Sharing on Record Sales: An Empirical Analysis* (2004) (available at <http://www.unc.edu/~cigar/papers/FileSharing_March2004.pdf>).

¹⁵ See *Commission of the European Communities*, Case No. COMP/M.3333 – Sony/BMG (decision of July 19, 2004) at ¶ 59 (available at <http://europa.eu.int/comm/competition/mergers/cases/decisions/m3333_en.pdf>).

¹⁶ Gautam Malkani, *Copyright's Haven of Stability*, FINANCIAL TIMES (Nov. 17, 2004).

¹⁷ Mary Madden, “Artists, Musicians and the Internet” (Dec. 5, 2004) (available at <http://www.pewinternet.org/PPF/r/142/report_display.asp>).

promote digital downloads. In fact, Heart managed to sell more downloads via P2P distribution than through Apple's iTunes Music Store, demonstrating the potential of P2P networks to unlock new sources of revenues for artists.¹⁸

- **The Movie Industry is Unscathed.** The movie industry has been enjoying its most successful years in history, chalking up record-breaking revenues in both box office receipts and DVD sales. There is no evidence whatsoever demonstrating that noncommercial P2P file-sharing among movie and television fans has undermined the incentives that keep Hollywood turning out the multi-million dollar spectacles for which they are famous (or infamous).

In light of this evidence, it appears premature to conclude that P2P file-sharing has put the entertainment industries in any grave peril. In fact, the existing evidence suggests that the entertainment industry is in a transition period, brought about by new technological innovations. For a century, new technologies have disrupted these industries, yet each time these technologies have ultimately enhanced the value of copyrighted works by creating new business opportunities. There is no reason to believe that P2P file-sharing technology will prove to be any different.

Respectfully submitted,

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¹⁸ Chris Marlow, *Artists Take Advantage of P2P Music Sharing*, THE HOLLYWOOD REPORTER (Aug. 25, 2004).